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IN THE

Supreme Court of the United States

October Term, 1956.

No. 167

HENRY A. MASTELLER, JAMES J. McGINNIS, ALBERT J. BADER, EARL D. STICKLEN, JOHN A. DRISCOLL, JAMES F. McGOWEN, THOMAS L. McNEE and GENERAL INDUSTRIES, INC.,

Petitioners,

v.

WALTER M. GRAFTON.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Henry A. Masteller, James J. McGinnis, Albert J. Bader, Earl D. Sticklen, John A. Driscoll, James F. McGowen, Thomas L. McNee and General Industries, Inc., your petitioners, pray that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Third Circuit entered in the above-entitled case on April 25, 1956.

OPINIONS BELOW.

Opinion of District Court of the United States for the Eastern District of Pennsylvania dated July 18, 1955 not reported.

Final Decree of District Court, dated September 20, 1955 not reported.

Opinion of Court of Appeals for the Third Circuit, dated April 25, 1956 not reported.

JURISDICTION.

1. The Decree of the United States District Court for the Eastern District of Pennsylvania was entered on September 20, 1955. The Judgment of the United States Court of Appeals for the Third Circuit, affirming the decree of the District Court, was entered on April 25, 1956.

2. The Jurisdiction of this Court is invoked under the provisions of 28 USC Sec. 1254 (1).

QUESTIONS PRESENTED FOR REVIEW.

Can a Federal District Court order a Pennsylvania Corporation to violate the public policy, Constitution and Statutes of the Commonwealth of Pennsylvania by ordering such Coporation to "forthwith issue and deliver" to the Plaintiff shares of stock for which Plaintiff gave a note which he has never paid or offered to pay.

THE CONSTITUTIONAL PROVISIONS AND STATUTES WHICH THE CASE INVOLVES.

Article 16, Section 7 of the Constitution of Pennsylvania:

> "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days notice given in pursuance of law."

Section 603 of the Pennsylvania Corporation Code, 15 P. S. 2852-603, 1933, May 5, P. L. 364, Article 6, Section 603:

> "A. Shares of a business corporation shall not be issued except for money, labor done, or money or prop-

erty actually received. Subscriptions for shares having a par value shall be made payable with money to an amount not less than the aggregate par value of the shares subscribed for or with consideration other than money, the fair value of which to the corporation is not less than the aggregate par value of the shares subscribed for. * * * (1933, May 5, P. L. 364, Art. VI, § 603.)

Section 604 of the Corporation Code:

"* * * No note or obligation given by a shareholder, whether secured by pledge or otherwise, shall be considered as payment, in whole or in part, of any shares of a business corporation." (1933, May 5, P. L. 364, art. VI, § 604.)

STATEMENT OF THE CASE.

In 1946 Respondent, Walter M. Grafton and three of the Petitioners formed the Petitioner-Corporation. At the organizational meeting of the Corporation, the Respondent was elected President and as President, signed four stock certificates, each representing fifty shares of stock in the Corporation of a par value of fifty dollars each. Two of the incorporators paid cash to the Corporation and received stock certificates filled out in their names. The Respondent and the fourth incorporator gave judgment notes in the amount of $2,500,[redacted] to the Corporation which were attached to the remaining stock certificates along with blank transfer powers which they also executed; and the certificates, notes, and transfer powers were held in the treasury of the corporation. Some time thereafter, the one Petitioner who had executed a note, paid the note, and received a stock certificate. The Respondent Grafton never paid the note, never offered to pay the note and never received a stock certificate. In the Spring of 1947, at a time when the Corporation was on the verge of financial collapse, the three Petitioners, feeling that the Respondent Grafton was not

devoting his efforts to the business, discharged him from his position as President of the Corporation and demanded payment of his note. When after a period of several weeks, the Respondent failed to pay his note, the Petitioners declared the stock forfeited. Three and a half years later, the company having attained a prosperous condition, the Respondent filed this bill demanding delivery to him of fifty shares of stock without however, offering to pay for it. The bill was filed in the District Court for the Eastern District of Pennsylvania. The basis for Federal jurisdiction was diversity of citizenship, the Respondent being a resident of New Jersey, and the Petitioners being residents of Pennsylvania. The District Court found for the Respondent and decreed that the Corporation should "forthwith issue and deliver" fifty shares of stock to the Respondent Grafton and that the Corporation account to the Respondent for any dividends that had been declared on the stock after deducting therefrom the subscription price of the stock. The United States Court of Appeals for the Third Circuit affirmed this decision.

REASONS FOR ALLOWANCE OF THE WRIT.

Your petitioners submit that the record of this case presents a substantial Federal question of far reaching effect. The Petitioner, General Industries, Inc., is a Pennsylvania Corporation which owes its very existence to the Constitution and Statutes of the Commonwealth of Pennsylvania. This Petitioner has been ordered by the Federal Court to "forthwith issue and deliver" stock in direct violation of the clear and unequivocal provisions of this Constitution and these Statutes. It is submitted that such a decree is incompatible with the ordered functioning of our Federal System.

It is respectfully submitted that the Court of Appeals erred in its finding that "this case involves no flouting of the basic policy underlying Pennsylvania strictures against

issuance of stock without prepayment". The Court in its opinion states:

> "It was understood that Grafton should render, as he did, full time services and the sum of $2500.00, thereafter to be paid out of his share of the profits as earned, should constitute the consideration of his stock."

The Supreme Court of Pennsylvania in *Gearhart v. Standard Steel Car Company*, 223 Pa. 385, 72 Atl. 699 (1909) said:

> "It is argued by counsel for the complainant that if this corporation could have issued fully paid-up stock to this complainant for his labor, then it could enter into a contract to issue to him for his labor, capital stock of the corporation, when it should be paid for out of the earnings of the company. But that is just what the act of assembly says a corporation may not do."[1]

The extent to which the Court of Appeals has misinterpreted the Law and Policy of Pennsylvania is indicated by the following sentence in its opinion:

> "For the evidence fully warranted the conclusion that the *call* on Grafton's stock was accelerated in derogation of the terms under which the stock was *issued*." (Emphasis supplied.)

This in a state which prohibits the issuance of stock except for "money, labor done or money or property actually received", and where nothing had been received from

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1. Although this case was decided under a prior statute, the language of that statute is almost identical to that of the present one: Act of April 29, 1874 P. L. 73 "no such corporation shall issue their bonds or stock, except for money, labor done, or money or property actually received . . ."

Grafton. It is submitted that this sentence betrays error on its face.

The Respondent in this case, has never paid or even offered to pay for this stock. The only action he took was to execute a note which is forbidden by the Constitution and the Statutes. The only legal claim which he could conceivably make under Pennsylvania Law is that the stock should be issued to him for services already performed, but this is not the claim which he has made nor is it the basis on which the District Court rendered its decision. In its adjudication the Court found that stock was issued to the Respondent for *services to be performed* in direct contradiction of the Constitution and Statutes of Pennsylvania. Moreover, the record is replete with uncontradicted evidence of the Respondent's failure to devote his time and effort to the corporation's business. The District Court touched but lightly on the question of Respondent's services:

> "The defendants seek to justify their discharge of the plaintiff on the ground that his work was unsatistory. The plaintiff is not suing for breach of a contract of employment, and defendant's right to terminate his status as an employee is not involved. Whatever his shortcomings may have been, they did not amount to a complete failure to perform such as might have justified the defendants in depriving him of his interest in the business. It may be that his abilities and his devotion to his job did not come up to expectations, but the defendants took that risk when they went into business with him."

But was not this perforce the very "risk" upon which had to be conditioned any issuance of stock to the Respondent? Such a "risk" is just what the Constitution and Statutes of Pennsylvania declare that a corporation may not take in the issuance of stock. Under the Constitution and Statutes of Pennsylvania no stock could legally issue

to the Respondent until the corporation received from him services of a value equal to the price of the stock, and such stock could be of no greater value than the value to the corporation of those services.

Issuance of stock comprises more than the mere writing of a name on a stock certificate. It is the position of your petitioners that stock was never issued to the Respondent within the meaning of Pennsylvania's Constitutional and Statutory prohibitions; and that to order the Petitioner-Corporation to "forthwith issue and deliver" stock—as did the decree of the District Court, as affirmed by the Court of Appeals, in direct violation of these provisions, is beyond the power of the Federal Court.

CONCLUSION.

It is respectfully submitted that this case presents at once a substantial federal question governing the relations between the Federal Authority and the States, and a decision on an important state question in conflict with applicable state law; and that therefore it is a proper case for review by certiorari in this Court, and that the petition for writ of certiorari should be granted.

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